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SUBJECT: PRICES STILL RISING BUT PROVINCES REMAIN CALM

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(B) Beijing 573
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SUMMARY

1. (SBU) Commenting on inflationary trends in their respective localities, government officials and citizens in two provinces outside Beijing recently expressed optimism that prices are stabilizing and said their regions have not so far experienced widespread social unrest or hoarding. Their comments followed the April 16 announcement by China's National Bureau of Statistics (NBS) that the Consumer Price Index (CPI) increased 8 percent in the first quarter of 2008, well above the Central Government's stated goal of containing inflation at 4.8 percent this year. According to the national figures, inflation remains largely the result of rising domestic food prices, which were up 21 percent in Q1, and the Central Government continues to provide subsidies to enable low-income urban residents to purchase meat. Experts in the two provinces we visited acknowledge, however, that there remain long-term structural concerns that threaten to apply upward pressure on prices. END SUMMARY.

CPI SURGE CONTINUES IN 1ST QUARTER

2. (SBU) China's first quarter economic statistics showed signs of slowing with GDP growth at 10.6 percent year-on-year (down from 11.7 percent in the first quarter of 2007) along with falling growth rates for exports, industry profit growth, the trade surplus, and both broad and narrow monetary aggregates. However, NBS statistics show that consumer prices continued their upward climb with the CPI rising 8 percent for the first quarter and 8.3 percent y-on-y in March (after reaching an 11-year high of 8.7 percent in February). By contrast, CPI growth in the first quarter of 2007 was only 2.7 percent. Food prices rose 21 percent in the first quarter, continuing to account for the bulk of the overall consumer price increase. The housing component of the CPI increased 6.6 percent.

3. (SBU) Public commentary on the first quarter figures indicated there is a broad consensus among analysts and economic officials that the Central Government will not meet its stated goal of containing inflation at 4.8 percent in 2008, which was announced during the March session of the National People's Congress. Tang Min, Deputy Secretary General of the China Development Research Foundation, told Emboffs on April 3 that he remains concerned that prices will continue to rise, particularly given growing pressure from higher international grain and soybean prices.

THE GOVERNMENT'S COUNTERMEASURES

¶4. (SBU) China's State Council introduced ten new measures to strengthen support for the rural sector on March 27, including the National Development Reform Commission's announcement of a rise in the minimum procurement prices for rice and wheat. Announcing the measures at the State Council meeting, Premier Wen Jiabao reportedly pledged RMB 25.2 billion (USD 3.6 billion) in budget support for the rural sector in addition to the RMB 562.5 billion (USD 80.3 billion) already planned in the 2008 budget, as the Central Government aims to stimulate agricultural production and combat high food prices by boosting supply.

¶5. (SBU) With a view towards social stability, the Central Government and local governments also have provided subsidies to enable low-income urban residents to purchase meat during the past several months. Contacts in Beijing and the provinces said they believe these measures have been more successful and less disruptive to the economy than administrative price ceilings would have been.

ALL QUIET IN THE PROVINCES

¶6. (SBU) Econoff traveled to Changsha, Hunan's Provincial Capital April 22-23, and Shijiazhuang, Hebei's Provincial Capital on April 16-17 to solicit views on inflation and its impact on social stability. Contacts in Hunan and Hebei -- where consumer prices have risen 7.4 percent and 8.2 percent respectively in the first quarter compared to a year earlier -- uniformly said there have been no cases of social unrest or hoarding due to rising prices in their provinces. The primary area of concern for social stability, according to provincial contacts, remains the urban poor, who already spend a high proportion of their income on food and are thus

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adversely affected by escalating prices for meat and edible oils. Wang Liugen, Director of the Finance Department in the Hebei Provincial Financial Securities Working Leading Group Office, noted that 87 percent of Hebei's inflation is from food prices, and Hebei's provincial government is especially focused on providing subsidies to poor urban residents to compensate for the price increases.

FARMERS BENEFITING FROM RISING FOOD PRICES

¶7. (SBU) Provincial contacts also expressed optimism that prices are stabilizing, adding that farmers have benefited from higher food prices to date. Peng Jianqiang, Director of the Rural Economic Institute at the Hebei Academy of Social Sciences stated that he is not too worried about food price increases because the domestic price surge has been the result of a natural supply shortage (especially of pork) that will correct itself in the near-term. Prices have attracted negative media attention in cities, Peng said, only because the prices of pork, grains, and edible oils all have increased at the same time (rising 63 percent, 6 percent, and 43 percent respectively nationally in the first quarter compared to a year earlier).

¶8. (SBU) In the meantime, Peng claimed, higher food prices are boosting per capita rural cash incomes, which increased 18.5 percent nationally in the first quarter of 2008 compared to a year earlier (see also Re A). Farmers on the outskirts of Changsha in Hunan Province confirmed that their agricultural income has increased rapidly in the last year. In particular, a pig farmer told Econoff on April 22 that his income from raising pigs increased four-fold between 2006 and 2007 due to higher pork prices. (According to national data, per capita rural cash income from the sale of all animal products increased 30 percent in the first quarter of 2008 compared to a year earlier.)

¶9. (SBU) NOTE: Local government officials and farmers in both provinces all said, however, that rural income gains are partially off-set by rising input costs. In Hunan Province, for example, officials at the Provincial Agriculture Bureau said fertilizer costs

increased 30 percent in 2007. A local flower and vegetable farmer outside Changsha said his living standard is improving because of higher prices, but rising costs definitely are cutting into gains (Ref B). END NOTE.

CONFRONTING LONG-TERM PROBLEMS

¶10. (SBU) Provincial contacts stated that while they are confident prices will stabilize soon, they remain concerned about long-term structural weaknesses in the economy that may exacerbate inflation. Ma Guohui, Deputy Director General of the China National Hybrid Rice Research and Development Center in Changsha, summarized the concerns, stating that in China:

(1) Small-scale farming is inefficient and slow to respond to supply shocks in the domestic economy;

(2) Industrial production costs are rising, which is driving up wages and creating an inflationary cycle; and

(3) Rising international prices are starting to affect the domestic inflation situation.

Ma echoed the call by his organization's leader, Dr. Yuan Longping (known in China as the "Father of Hybrid Rice"), to focus more attention on agricultural technology in order to increase yields and meet growing demand.

COMMENT: STABLE FOR NOW

¶11. (SBU) Looking at government statistics as well as comments by private analysts, the conventional wisdom -- first reported at the end of 2007 (Ref C) -- that CPI inflation will come in between 6 and 8 percent this year, and is in little danger of spiraling out of control, appears to be holding. Our visits to Hebei and Hunan reinforce the impression of continued social stability despite price hikes as incomes grew even faster. That being said, the government will continue to monitor the impact of higher prices on the urban poor and will pay close attention to rising input costs in the countryside as it attempts to manage the higher expectations of a population now accustomed to rapid real income growth.

APPENDIX: LOCAL VIEWS FROM HUNAN AND HEBEI

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¶12. (SBU) In Changsha, Hunan Province, Econoff met with officials at the Hunan Provincial Agriculture Bureau, Hunan Academy of Social Sciences and National Hybrid Rice Research and Development Center as well as with farmers on the outskirts of the city. In Shijiazhuang, Hebei Province, Econoff met with officials from Hebei's Finance Bureau, Education Bureau, and Academy of Social Sciences. In both provinces, Econoff and Econ Assistant also interviewed average citizens about their personal views on rising prices. A sampling of those views is provided below:

--Engineer at the State Electricity Company, Beijing-Shijiazhuang train--electricity prices unchanged, but Shijiazhuang residents continue to be worried about increasing food prices.

--Grocery store clerk, Shijiazhuang--the price of food oils started increasing significantly after Chinese New Year in February, but otherwise, price increases have not been too severe.

--Migrant farmer from Henan Province, Shijiazhuang--selling walnuts in city and will return home at grain harvest time. Income has been pretty good because of food price increases, especially from grains.

--Hebei Provincial Foreign Affairs Officer, Shijiazhuang--restaurant prices going up but not that big of a deal. He and his wife (they also have a 10-month-old daughter) do not want to hire a housekeeper because it would be too expensive.

--Tour guide, Bailin Temple, Zhao County, Hebei Province--not much tourism during the week, but historic sites continue to draw heavy crowds on the weekends.

--Taxi driver, Changsha--spends money as soon as she earns it and doesn't "worry about tomorrow." Has noticed price increases but not concerned enough to change spending behaviors.

--Hunan Foreign Affairs Officer, Changsha--definitely have noticed rising housing prices in Changsha, but food prices seem to be a relatively minor issue.

--Flower and vegetable farmer, Xinjiang Village, Changsha County--food price increases have been good for farmers, and he lives comfortably, renting 80 mu in addition to the four mu he owns. Hunan residents also recognize the pace of food price increases has not exceeded that of income increases.

--Pig farmer, Xinjiang Village, Changsha County--income has increased four-fold since 2006 because of higher pork prices. Hopes prices will remain high, but he does not want prices to increase further as that might attract new entrants into the market and suppress prices in the long-run. He added that he has done well because Blue Ear disease broke out in Sichuan Province but did not affect pigs in Hunan Province.